DOCKET FILE COPY ORIGINAL

RECEIVED

JAN 3/2 1992

BEFORE THE FEDERAL COMMUNICATIONS COMMISSION OFFICE OF THE SECURITARY FEDERAL COMMUNICATIONS COMMISSION OFFICE OF THE SECURITARY

		- CARLA
	In The Matter of)	
	Treatment of Operator Services) CC Docket No. 93- Under LEC Price Cap Regulation)	124
	COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY	-
	Southwestern Bell Telephone Company (SWBT), pursua	nt to
	the Notice of Proposed Rulemaking released May 26, 1993. h	erebv
	<u> </u>	
-7		
-		
-		
<u></u>		
1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1		
	2,4	
- 		
· · · · · · · · · · · · · · · · · · ·		
-		

communications system that offers innovative, high quality services.

To date, virtually all of the modifications and "fine tuning" to LEC Price Cap Regulation have operated to constrict LEC pricing flexibility and to eliminate the underlying premise of price caps—that LECs should have incentives to operate more efficiently and cost-effectively. The modifications have thus depressed the incentives to offer innovative, high quality services. The proposed change for operator services will push LEC Price Cap Regulation further away from its goal.

The Commission has the responsibility to carry out the Communications Act's stated policy of encouraging the provision of new services, and is also required, in determining the justness and reasonableness of rates, not to only make the rates just and reasonable for ratepayers, but to consider a fair return to the utility stockholders. Thus, if LEC Price Cap Regulation does not provide proper incentives for the introduction of new, innovative services, and does not consider the need to provide a fair return for LEC shareholders, it does not fulfill the Commission's responsibilities. Likewise, if a proposed change to LEC Price Cap Regulation does not provide proper incentives for the introduction of new services, and consider the need to provide a fair return to

II. THE PROPOSED PRICE CAP TREATMENT OF OPERATOR SERVICES SHOULD BE REJECTED.

LEC Price Cap Regulation has already been unduly complicated. The NPRM would further complicate LEC Price Cap Regulation by establishing a new "Operator Services" category in the Traffic Sensitive Basket. Banding limitations would apply to this new category similar to those that apply to other traffic sensitive categories (plus or minus five percent per year adjusted for changes in the basket's price cap index.)

This treatment would unreasonably restrict the pricing of operator services. Operator services must be allowed more flexibility because of the competitiveness of the market and because of the need to make LEC Price Cap Regulation less, not more, complex.

There is no apparent need to create a separate service category for interstate operator services. The history of price changes for interstate operator services within SWBT, like other of the price cap LECs, shows that prices for 0- Transfer, Line Status Verification or Busy Line Interrupt have not increased since these services were first tariffed. The competitive concerns listed below have led to these favorable pricing trends. Thus, no valid reason is listed in the NPRM to warrant any changes to price cap rules prior to the comprehensive LEC price cap review.

The operator services being discussed here are not services of companies who have generally been the subject of public reaction and who gave rise to legislation like the Telephone Operator Services Consumer Improvement Act (TOSCIA), and resulting increased regulation, such as Alternative Operator Services (AOS) providers. See generally, Orders in CC Docket No. 90-313. SWBT is in compliance with the regulations promulgated by this docket.

The Commission has previously recognized that parties bear a high burden of proof to justify price cap rules changes prior to the comprehensive review. Thus, to the extent that restrictive changes such as those proposed by the NPRM are proper at all, they would more properly await the comprehensive review.

A. The Operator Services Market is Competitive.

As has been noted in various state and federal proceedings (e.g., CC Docket Nos. 90-313, 92-77), competition is pervasive in the operator services market. This fact is underscored by the sheer increase in the number of operator service providers that have entered the market in the last five years.

Competition for 0- Transfer service arises from multiple forces. First, the consumer education campaigns undertaken by IXCs is a competitive force. AT&T aggressively promotes the use of "10288+0" and "1+800+321-0288" to "always reach an AT&T operator." Similarly, MCI has just recently launched a massive nationwide campaign for "Collect" service (1+800+COL-LECT). Both of these campaigns demonstrate the competitive nature of operator services and are substitutes for 0- Transfer Service. As callers learn they can reach their preferred carrier(s) through the use of access code dialing arrangements, the need for 0- Transfer Service decreases. Thus, access code dialing instructions provide competition to the 0- Transfer service at issue herein. Customers can also use a

⁶ Amendment of Part 61 of the Commission's Rules, 7 FCC Rcd. 6632 (1992) at para. 5.

⁷ In the case of AT&T, the Commission actually ordered AT&T to educate its customers on the use of access codes. <u>See generally</u>, CC Docket No. 92-77.

phone with the following dialing options to complete an operator assisted call 0-; 00-; 10XXX+0; 1+800+NXX-XXXX; 950+0/1XXX; 0+NPA+NXX-XXXX. All of these dialing options may not be able to be used for billing all calling cards from all phones, but the extent of options clearly places competitive pressure on the price of the LEC 0- Transfer Services.

Aggressive IXC customer education programs, which advertise alternatives to 0- dialing, exert significant pricing discipline on SWBT.⁸ Placing operator services in a separate basket will not allow SWBT the pricing flexibility it needs to meet this competition.

The use of "redialers" within the network is also a competitive force for the services at issue. In many instances, when callers dial either "0" plus a distant number (i.e., "0+"), or just simply "0" and nothing more (i.e., "0-"), their calls are "redialed" or "redirected" away from the LEC and presubscribed IXC to an alternative OSP. This is accomplished by placing "redialers" or "autodialers" within the network between the instrument and end office. 9 In most cases, this action effectively blocks a caller

SWBT has previously filed data on the extent to which an IXC will educate consumers on their ability to avoid the use of a SWBT operator. See, Petition for Reconsideration of Southwestern Bell Telephone Company, filed in CC Docket No. 92-77, Phase I, on January 11, 1993.

For years, the Commission has recognized the capabilities and use of redialers in PBX equipment and other CPE, including "store and forward" devices. See, Telecommunications Research and Action Center and Consumer Action, Complainants, v. Central Corporation; International Telecharge, Inc.; National Telephone Services, Inc.; Payline systems, Inc.; and Telesphere Network Inc.; defendants, 4 FCC Rcd. 2157 (1989), at para. 5; Policies and Rules Concerning Pay Telephone Operator Service and Pay Telephone

from being able to reach the LEC associated with the originating line. As calls are "redirected without recourse", opportunity for service is denied to the LEC. In this case, the lost opportunity would include 0- Transfer Service. The continuing use of such devices has a detrimental effect on demand for LEC services. SWBT must be able to competitively respond to such tactics and forces. In this case, the greater pricing flexibility afforded by leaving operator services within its existing basket must be retained.

In the Memorandum Opinion and Order on SWBT's petition for waiver to allow SWBT to establish new rate elements for operator services, namely the services of 0- interLATA, interexchange transfers, and inward assistance services, the Bureau discussed challenges to those that opposed SWBT's offering of the 0-transfer service. The Bureau stated:

0- transfer services appear to be beneficial to consumers. For example, some consumers will undoubtedly appreciate the ease of dialing merely 0-. Secondly, 0- transfer services are merely providing an alternate way for the end user to reach the IC of his choice--a choice the end user should already have by using an access code or dialing an 800 or 950 number. 10

Thus, the Bureau has recognized that there are alternatives to the operator services offered by SWBT, and that there is a form of competition for these services.

Compensation 6 FCC Rcd. 9736 (1991) at fn. 135; Policies and Rules Concerning Operator Service Providers, CC Docket No. 90-313, Notice of Proposed Rulemaking (FCC 90-231) (released July 17, 1990) at fn. 32.

¹⁰ Southwestern Bell Telephone Companies, Petition for Waiver of Section 69.4(b) of the Commission's Rules, Transmittal No. 1874, 5 FCC Rcd. 3452 (1990), at para. 26.

Since there is ample competition to SWBT operator services, there is no need to handicap SWBT's provision of these services through placing them in a new category with banding limits. These types of restrictions reduce the pricing flexibility needed to effectively compete with the alternative sources of supply.

B. The Addition of More Complexity to LEC Price Cap Regulation Further Reduces the Incentives to Introduce New Services.

The lack of pricing flexibility also reduces the incentives for SWBT to introduce new services. If such new services are likely to be subject to the same type of pricing restrictions, then profits for such new services are potentially limited. Services of questionable profitability are thereby discouraged.¹¹

C. The NPRM's Proposal is Essentially "Rate Element" Banding.

Over 95% of the revenues from the rate elements involved here are from the 0- transfer service. Since so much of this issue is concentrated in a single rate element, the Commission's proposal is essentially rate element banding. In 1989, the

The Commission, in ordering price cap regulation for the LECs, concluded that "there are economic benefits to be obtained form moving away from a system in which regulators dictate prices on the basis of fully distributed pricing principles, toward a system of limited pricing flexibility." <u>LEC Price Cap Order</u>, para. 35.

¹² See, for example SWBT's april 2, 1993 Annual Access Filing, Transmittal No. 2271, Figure 9, B-1, p. 5 of 5, which yields a

Commission concluded that rate element banding is not required to protect customers. 13

III. EVEN WITHOUT THE PROPOSED CHANGE, LEC PRICE CAP REGULATION IS TOO RESTRICTIVE.

SWBT originally supported price cap regulation for LECs and continues to support the theory under which it was originally proposed. At the time it was first raised in a formal notice, SWBT believed it could offer great advantages for the introduction of new services. Since that time, however, the Commission has made numerous changes to that original concept, virtually all of which diminish the incentives to develop and offer new services. Given this background, it is especially important for the Commission to avoid further damaging LEC Price Cap Regulation as proposed in the NPRM.

Appendix A attached hereto and hereby made a part of this

increased competition are not so different between the IXC and the LEC markets so as to warrant fundamentally different changes in pricing flexibility. Thus, the changes to the LEC Price Cap Plan are unjustified. Should the Commission persist in its proposal that would further complicate LEC Price Cap Regulation and push it away from its objective, the Commission must also consider other measures of flexibility for Price Cap LECs to balance the loss of incentives.

IV. CONCLUSION.

LEC Price Cap Regulation already contains serious disincentives to the provision of new services. The proposed treatment of operator services will only aggravate this situation. Therefore, SWBT respectfully requests that the Commission drop its proposal to further restrict LEC Price Cap Regulation by establishing a new "Operator Services" category in the Traffic Sensitive basket.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY

James E. Taylor

Richard C. Hartgrove

Thomas A. Pajda

Attorneys for Southwestern Bell Telephone Company

One Bell Center. Room 3520

CHANGES TO LEC PRICE CAP REGULATION THAT HAVE MADE IT UNABLE TO MEET ITS OBJECTIVE

A. Effective LEC Price Cap Regulation Was Not Implemented.

The LECs were handicapped at the outset of LEC Price Cap Regulation because of a number of decisions that were made at the end of the lengthy notice and comment process. Time has shown that these decisions seriously hinder the ability of LECs to introduce new services.

1. Productivity Offset.

LECs to reduce their costs by a reasonable amount through the use of an annual productivity adjustment. SWBT suggested that a productivity offset of no more than 2% [?] would be proper. A productivity offset of 3.0% was required in the AT&T price cap proceedings. Nevertheless, the Commission established a 3.3% minimum productivity offset, contrary to what SWBT has achieved

The Commission's continued rejection of SWBT's Mid-Course Tariff Filing has also caused a reduction in SWBT's ability to earn under Price Cap Regulation, and thus has worked to make the rates charged by SWBT under Price Cap Regulation unjust and unreasonable as to SWBT's investors. SWBT entered Price Cap Regulation by million dollars below its authorized return. SWBT's Transmittal No. 2051 (Midcourse filing) asked the Commission to correct this inequity, however, the Common Carrier Bureau rejected the transmittal in 1991 and this result was affirmed by the Commission in 1992. In mid-1992, SWBT filed its opening brief with the U.S. Court of Appeals for the D.C. Circuit, and the Commission requested a remand of the proceedings. While SWBT was hopeful that the Commission's request for a remand meant that the Commission

over time (under 2%). This error continues to unduly depress LEC Price Caps, significantly limiting the earnings available to introduce new services.

2. Sharing Adjustment.

A Commission decision that will make it more difficult for LECs to increase their earnings over time, assuming that LECs can cross the other regulatory hurdles to higher earnings, is the requirement of "sharing". The sharing of profits thereby operates to decrease the earnings available to support new services.

Under the original concept of LEC Price Cap Regulation, LECs were to be given the incentive of keeping all of their profits in order to become as efficient as possible and to provide new and

the Commission required that 50% of the benefits of demand growth for Common Line must be shared with customers by lowering Common Line rates. This requirement effectively raises the minimum productivity offset to 5% and eliminated half of any potential increased earnings from increased Common Line demand. The loss of the earnings also reduces the amount of funds available to support the introduction of new services. [Reconsider section after examining ROR of Common Line.]

B. <u>LEC Price Cap Regulation Was Made Worse Since</u> Implementation.

As shown above, LEC Price Cap Regulation was beset with problems at its inception for the LECs. Yet, LEC Price Cap Regulation has not remained static throughout its existence. The Commission has had numerous opportunities to adjust its terms and structure. Nevertheless, the adjustments have almost always operated against the objective of the Commission, as shown by the following sections.

1. New Service Pricing.

Order Trestrain the LECs' ability to recover the new service development costs in the prices of those services. Instead of merely requiring a net revenue test, the Commission eliminated the net revenue test and determined that new interconnection services must be justified by direct cost plus reasonable overheads and that subsequent price changes cannot be more than 2%. [need more background.] These requirements are more onerous than under rate of return regulation and result in reduced pricing flexibility and earning potential for new services and diminish the incentives, if any, to offer new services.

^{17 [}Cite to July 11 Order.]

Even though part of the key objective of price cap regulation was to facilitate the introduction of new services, the new services pricing rules directly constrain the incentives for LECs to introduce such new services.

2. New and Restructured Services Decisions.

The <u>LEC Price Cap Order</u> distinguished between new and restructured services. New services were allowed to be held outside of Price Cap baskets for a limited period. Restructured services, on the other hand were not allowed to be held outside of Price Cap baskets, but were required to comply with existing Price Cap Index, service category, banding and subindex constraints. 18

The 800 Database Order found that 800 Database "does not fall squarely within the definitions of either a new or restructured service", and went on to treat 800 Database as a "restructured" service, forcing it to comply with existing price cap index service category banding and subindex constraints. 19 Instead of progressively moving to allow 800 Database to be treated as a new service, which would allow easier recovery of the substantial capital and expense required to offer 800 Database, the Commission has required restructured treatment, merely allowing a limited exogenous cost adjustment for the additional expenditures. This decision makes it more difficult for SWBT's rates for 800 Database service to provide earnings for other new services, and exemplifies the difficulty faced by LECs in bringing a new service to the market. [Expand this explanation.]

3. Exogenous Cost Treatment.

^{18 [}Cite]

^{19 [}Cite]

The Commission has had a number of opportunities to tune LEC Price Cap Regulation through the requests that LECs have made for exogenous treatment of various costs. The Commission has also dealt with questions of exogenous treatment that it has taken up on its own motion. The Commission's usual response to exogenous treatment questions has, however, not encouraged new service development.

Under LEC Price Cap Regulation, LECs are required to lower their prices by at least 3.3% in real terms each year, as adjusted for what are termed "exogenous costs." Exogenous costs are generally defined as those caused by judicial, legislative or regulatory action, and are outside the control of the LECs. The designation of a cost as exogenous can work to either raise or lower a LEC's prices, depending upon the effect of that cost upon the LEC. Thus, the decision on whether a cost is treated exogenously or not can affect LEC rates and the earnings available to introduce new services. 21

If a cost is decreasing over time, and it is designated as exogenous, the phaseout of that cost will be required to be flowed through to rates, and will have the effect of lowering prices. If a cost is rising over time, and is designated as exogenous, flowing through that cost to LEC rates will increase them.

A prime example of how a Commission decision on exogenous treatment has affected the earnings potential of LEC rates is the Commission's decision on the treatment of OPEB costs. At the outset of Price Cap Regulation, the Commission indicated that OPEB costs could be treated as exogenous, or would otherwise be allowed to be included in LEC rates. In particular, the Commission permitted LECs that accrued OPEB expenses prior to FAS-106 implementation to include these expenses in their rates. In 1992, the Commission considered whether carriers that later adopted FAS-106 accounting could include OPEB expenses in their rates. LECs showed that OPEB expenses complied with the Commission's existing tests for exogenous cost treatment. Nevertheless, the Commission redefined the test for exogenous cost treatment, applied it to the LECs, and then held that the LEC filings were insufficient to qualify OPEB costs for exogenous treatment. LECs have petitioned for review of this decision to the U.S. Court of Appeals for the D.C. Circuit. [Cite.]

Proceedings in which the Commission has decided exogenous treatment questions have almost uniformly been resolved against the interests of new service introduction. During the first two calendar years in which LEC Price Cap Regulation was in place, the net total effect of all exogenous cost decisions upon the LECs exceeded \$1.4 Billion. The chart attached as Exhibit___ shows that the Commission's decisions on the exogenous treatment of the RDA and inside wire amortizations, the SPF and DEM adjustments, and the rate of return represcription, balanced against the decisions on exogenous treatment of the excess deferred tax and ITC amortizations, result in a large exogenous cost reduction to LEC rates. 22

4. Monitoring Obligations.

[Is there anything we can say here that impacts our earnings or the introduction of new services?]

5. The Expansion of Baskets, Service Categories, Sub-Indexes, and Bands Has Made LEC Price Cap Regulation Especially Complex.

A key failure of the Commission's development of Price Cap regulation has been the Commission's inability to have it incorporate new services without adding new baskets, service categories, subindexes, and bands to LEC Price Cap Regulation. The Commission has expanded the number of baskets, service categories, subindexes and bands when faced with new regulatory developments in two major proceedings, expanded interconnection and transport restructure. The instant proceeding proposes the same mistaken treatment for operator services.

While the Commission recently allowed the treatment of some 800 database costs as exogenous, this decision merely lessened the effect of another incorrect decision, that of treating 800 database services as "restructured" rather than "new." The effect of this decision on Price Cap Regulation is discussed above in Subsection 2.

By its proposal here, and by its actions in the other two named proceedings, the Commission continues to make LEC Price Cap Regulation especially complex in those areas where competition is expanding the most -- precisely where more, not less, flexibility is needed.

a. Transport Restructure.

One instance in which LEC Price Cap Regulation has been unduly complicated is with the new structure for switched transport. The Commission concluded that special scrutiny for the new rates was required beyond the price cap "restructured" service rules. Direct-trunked and tandem-trunked switched transport were put into separate service categories, with the new entrance facilities charge included in the same service category as direct-trunked transport. Direct-trunk transport is subject to a 5% pricing band and the tandem-switched transport service category is subject to a 2% band for price increases and 5% band for price decreases. The interconnection charge is in a separate service category and is subject to a 0 % upward pricing band. Thus, the Commission has restrained the earnings potential of the LECs. These restrictions make it more difficult for these rates to provide profitable incentives for new transport services.

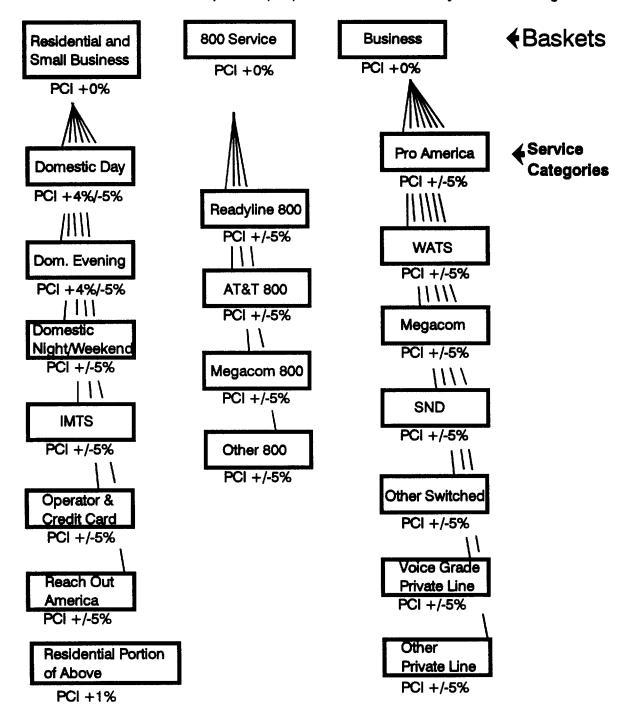
b. Expanded Interconnection.

In the expanded interconnection docket, the Commission strictly limited the pricing flexibility to be granted to LECs by creating new price cap subindexes to reflect the new rate zones for DS1, DS3 and other special access services. New subindexes are required for each of the rate zones and for each of the services. Rate bands applicable to the new subindexes employ a 5% upper band and 10% lower band. The weighted average for rates in all the zones must continue to fall within the existing 5% overall pricing

bands applicable to existing DS1 and DS3 subindexes. Thus, price cap regulation is being used to closely limit the pricing flexibility that the zone density plans will allow. This practice will seriously handicap the ability of those pricing plans to provide rates that result in earnings available to introduce new services.

AT&T Price Cap Plan At Implementation (7-1-89)

Each Basket has its own Price Cap Index (PCI) = Inflation - Productivity Offset +/- Exogenous.

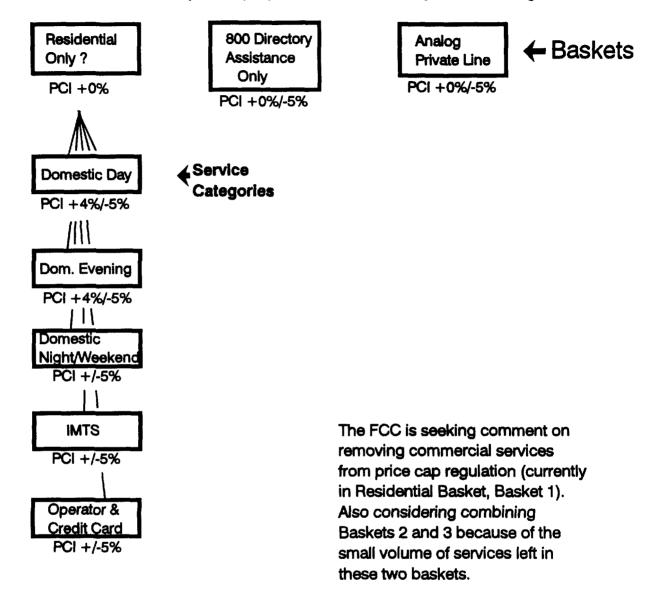


Productivity offset 3%. No sharing.

Excluded from price caps: Special construction, packet switching, Skynet, Tariff 11 services, Tariff 12 services (contracts, ICBs, special routing arrangements, Defense Network DTSN, VTNS), Tariff 15 services (Holiday Rate Plan, Competitive Pricing Plans), Tariff 16 services (FTS 2000, others)

AT&T Price Cap Plan Now, with Proposed Changes

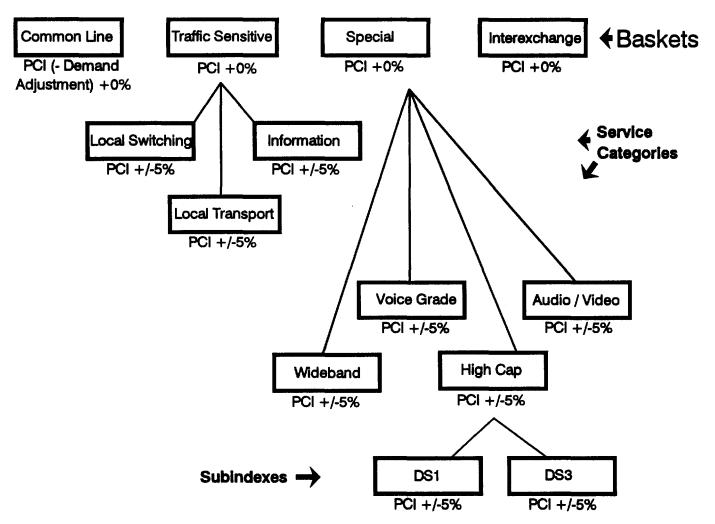
Each Basket has its own Price Cap Index (PCI) = Inflation - Productivity Offset +/- Exogenous.



Excluded from price caps: ReachOut and other Optional Calling Plans, business services (except analog private line) including digital private line, WATS, 800 service (except 800 Directory Assistance), switched services, Megacom, Pro America, special construction, packet switching, Skynet, Tariff 11 services, Tariff 12 services (contracts, ICBs, special routing arrangements, Defense Network DTSN, VTNS), Tariff 15 services (Holiday Rate Plan, Competitive Pricing Plans), Tariff 16 services (FTS 2000, others). AT&T has rapidly exapnded is contracted and customer-specifc services.

LEC Price Cap Plan At Implementation (1-1-91)

Each Basket has its own Price Cap Index (PCI) = Inflation - Productivity Offset +/- Exogenous.

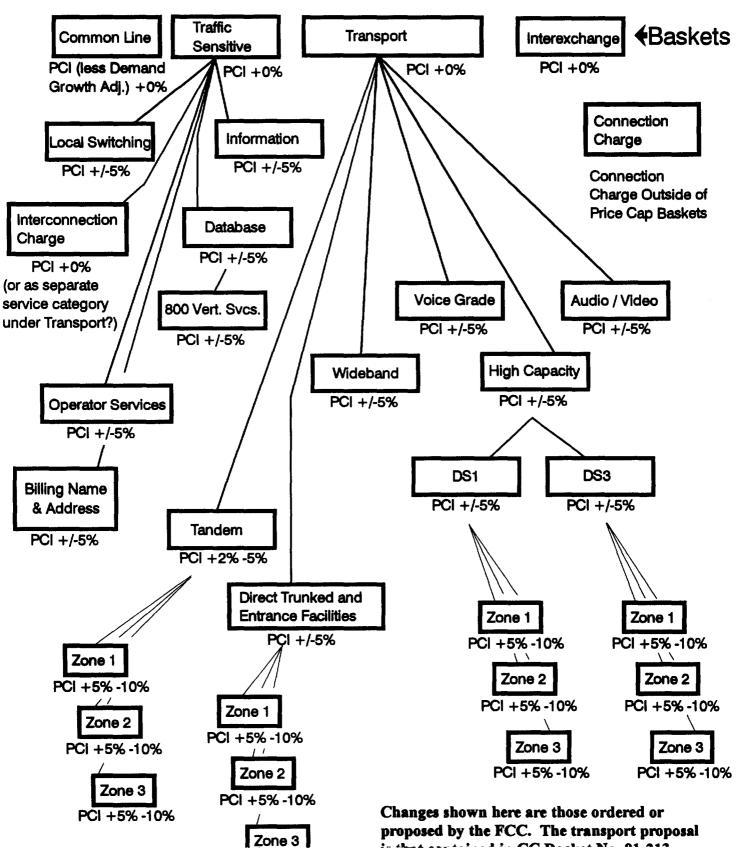


Productivity Offset 3.3%, with 4.3% option. 50/50 Sharing, with eventual 100% sharing.

Excluded from price caps: special construction; packet switching; PIC change charges; air-ground service; contract offerings in combination with interexchange carriers for services to the Federal Government.

LEC Price Cap Plan Now, with Proposed Changes

Each Basket has its own Price Cap Index (PCI) = Inflation - Productivity Offset +/- Exogenous.



CERTIFICATE OF SERVICE

I, Kelly Brickey, hereby certify that the foregoing "Comments of Southwestern Bell Telephone Company" in Docket 93-124, has been served this 6th day of July, 1993 to the Parties of Record.

Kelly Brickey

July 6, 1993

Tariff Division, Common Carrier Bureau 1919 M Street, N.W., Rm. 518 Washington, D.C. 20554 (2 copies)

International Transcription Serv., Inc. 2100 M Street N.W. Suite 140 Washington, D.C. 20037